IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

ITA No.521 of 2005
Date of decision:16.11.2006

Commissioner of Income Tax, Ludhiana-I

....Appellant

versus

M/s. Rico Auto Industries Limited, Ludhiana

....Respondent

CORAM: HON'BLE MR. JUSTICE ADARSH KUMAR GOEL
HON'BLE MR. JUSTICE RAJESH BINDAL

Present: Mr. SK Garg Narwana, Advocate for the revenue.
Mr. SK Mukhi, Advocate, for the assessee.

JUDGMENT:

This appeal has been preferred by the revenue against the order dated 18.4.2005 passed by the Income Tax Appellate Tribunal, Chandigarh Bench 'B', Chandigarh (for short, 'the Tribunal') in ITA No.1220/Chandi/97, for the assessing year 1994-95, proposing following substantial question of law:-

> "Whether on the facts and circumstances of the case, the Hon'ble Income Tax Appellate Tribunal was justified in law in deleting the disallowance of Rs.13,88,469/- made under section 36(1)(iii) of I.T.Act, when the Respondent had diverted interest bearing funds taken from banker cash credit account to its sister concern for non-business purposes on interest free basis?"

We have heard learned counsel for the parties at length for final determination of the above referred substantial question of law, which, in our opinion, do arise for determination by this Court.

Briefly the facts are that the assessee claimed deduction under section 36(1)(iii) of the Income tax Act, 1961 (for short, 'the Act'), which

was disallowed by the Assessing Officer on the ground that the assessee diverted its interest bearing funds to its sister concern namely M/s Rico Agriculture Oil Limited free of interest for non-business purposes. This view was upheld by the CIT(A). The Tribunal accepted the plea of the assessee that advances were made out of its own funds which was accepted by the department in the preceding and succeeding assessment years.

Learned counsel for the revenue relied upon judgment of this Court in **CIT, Ludhiana v. M/s Abhishek Industries Limited,** ITA No.110 of 2005, decided on 4.8.2006 wherein this court observed:-

> "As far as the issue of establishment of nexus of the funds borrowed vis-a-vis the funds diverted towards sister concern on interest free basis is concerned, in our view, the stand of the assessee that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest is on the Revenue is not correct. Section 36(1) (iii) of the Act provides for deductions of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of accounts, the onus will be on the assessee to satisfy the Assessing Officer that whatever loans were raised by the assessee, the same were used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee had advanced certain funds to sister concerns or any other person without any interest, there would be very heavy onus on the assessee to be discharged before the Assessing Officer to the effect that inspite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, still there was justification to advance loans to sister concerns for non-business purposes without any interest and accordingly, the assessee should be allowed deduction of interest being paid on the loans raised by it to that extent. In our view, even the plea of nexus of loans raised by the assessee with the funds advanced to the sister concerns on interest free basis, may be it is pleaded to be out of sale proceeds or share capital or different account cannot be accepted.
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> Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate

identification. Sources has no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed.

If the plea of the assessee is accepted that the interest free advances made to the sister concerns for non-business purposes was out of its own funds in the form of capital introduced in business, that again will show a camouflage by the assessee as at the time of raising of loan, the assessee will show the figures of capital introduced by it as a margin for loans being raised and after the loans are raised, when substantial amount is diverted to sister concerns for non-business purposes without interest, a plea is sought to be raised that the amount advanced was out of its capital, which in fact stood exhausted in setting up of the unit. Such a plea may be acceptable at a stage when no loans had been raised by the assessee at the time of disbursement of funds. This would depend on facts of each case.

Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon the assessee, as the facts are

> within its special knowledge. However, a presumption may be raised in a given case as to why an assessee who for the purpose of running its business is required to borrow money from banks and other financial institutions would be giving loan to its subsidiary companies and that too when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries."

Learned counsel for the assessee submitted that the sister concern was under an obligation with Industrial Finance Corporation of India of taking a loan without interest and on that ground,, the judgment of this Court was distinguishable. We do not find any relevance of sister concern having undertaken any contractual liability of taking loan without interest, for the purpose of deciding the claim of the assessee for interest when interest free loan was advanced to sister concern for non-business purposes. Present case is fully covered by the view already taken by this Court in **M/s Abhishekh Industries Limited'**s case (supra) and view taken by the Tribunal is contrary to the view taken by this Court.

Accordingly, we are satisfied that substantial question of law raised by the revenue is liable to be answered in favour of the revenue and against the assessee.

In view of the above, while answering the substantial question referred to above in favour of the revenue and against the assessee, we allow this appeal and set aside the order of the Tribunal.

(Adarsh Kumar Goel)
Judge

November 16, 2006
'gs'

(Rajesh Bindal)
Judge